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IN THE

Supreme Court of the United States

OCTOBER TERM, 1929.

L. M. WILLCUTS, as Collector of Internal Revenue for the District of Minnesota, Petitioner,

v.

CHARLES W. BUNN, Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

Motion of the People of the State of New York for Leave to File Brief as Amicus Curiae, and Brief of Amicus Curiae.

HAMILTON WARD,
Attorney General of the State of New York.

HENRY S. MANLEY,
Assistant Attorney General,
Counsel for Amicus Curiae.

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BATAVIA, N. Y.

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No. 535.

IN THE

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OCTOBER TERM, 1929.

L. M. WILLCUTS, as Collector of Internal Revenue for the District of Minnesota, Petitioner,

v.

CHARLES W. BUNN, Respondent.

Motion for Leave to File Brief as Amicus Curiae.

May it Please the Court:

The undersigned, as counsel for the People of the State of New York, respectfully move this Honorable Court for leave to file the accompanying brief in this case as *amicus curiae*.

HAMILTON WARD,
Attorney General of the State of New York,

HENRY S. MANLEY,
Assistant Attorney General,
Counsel for the State, as Amicus Curiae.

No. 535.

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1929.

L. M. WILLCUTS, as Collector of Internal Revenue for the District of Minnesota, Petitioner,

v.

CHARLES W. BUNN, Respondent.

BRIEF ON BEHALF OF THE PEOPLE OF THE STATE OF NEW YORK, AMICUS CURIAE.

Preliminary Statement.

OPINIONS BELOW.

The opinion of the District Court (R. 4) is reported in 29 F. (2d) 332. The opinion of the Circuit Court of Appeals for the Eighth Circuit (R. 15) is reported in 35 F. (2d) 29. Certiorari was granted by this court on January 27, 1930.

FACTS.

It appears that the respondent purchased in 1919 and 1920, as investments, certain bonds issued by counties and cities in Minnesota. In 1924 he sold these bonds at a net profit (not including accrued interest).

POSSIBLE INADEQUACIES OF THE RECORD.

The purchase price, the sale price, and the interest rate involved, do not appear. Whether the purchase was from the municipalities, and if so whether by bid, and if by bid whether directed to the purchase price or the interest rate or both, do not appear.

DECISION.

Both courts below decided that the profit involved is not subject to federal tax as income; that it is exempt upon the same constitutional considerations applicable to interest derived from the same bonds.

QUESTION.

Has the tax in question such an appreciable tendency to burden the fiscal operations of the municipalities involved, that it is constitutionally objectionable, in general and without showing more than is shown by the present record?

INTEREST OF THE STATE.

The State deems itself interested to have the question stated above given a negative answer. It does not claim, on behalf of itself or its municipalities, that the tax in question has any appreciable tendency to burden its or their fiscal operations. It does claim that it is embarrassed by certain corollaries of the doctrine expounded by the courts below, as follows: (1) The State has heretofore subjected and is subjecting to its income taxes, profits derived upon sales of federal securities; accordingly it is interested to oppose a determination suggesting the unconstitutionality

of such taxation. (2) All bonds of the State and its municipalities are issued at par or above, and retired at par, due allowance being made for any such difference as a loss deductible under the state income tax law and amortizable under the federal income tax law; accordingly the State is interested to oppose a determination requiring profits to be ignored, and thus logically requiring that losses be ignored.

In the two matters suggested, the State believes that its present rule is a just expression of the principle of income taxation. It will argue below that the record discloses no constitutional exigency to which the principle must be subordinated.

Argument.

Almost all bonds issued by the State of New York and its municipalities, are offered for sale at par, the interest rate to be fixed by competitive bidding. Various provisions of statute law, applicable to the various municipalities, forbid them to sell their bonds for less than par. They can fix an interest rate which will result in bids of par or above, but of late years the almost invariable practice has been to offer at par and let the bidders fix the interest rate. The prospective purchaser who offers to pay par for the bonds, and be content with a specified rate of interest below that specified by any other bidder, buys the issue.

If such a bidder is guided by the present practice and regulations of the federal taxing authorities, he anticipates that any profit derived, or any loss incurred, upon a subsequent resale, will be taken into account in computing his taxable net income for the year of resale.

Will this anticipation have any appreciable tendency to base the offer to the municipality upon an interest rate less attractive to it?

That question is to be answered in the affirmative upon one assumption only: *that profitable resale is the universal motive of bidders.* If there is any participation in the bidding by persons seeking an investment for duration of the issue, and hence representing the ultimate or highest market for bonds, sale will be upon a basis anticipating no resale, profitable or unprofitable. If the contingency of resale is weighed at all by such a bidder, the normal expectation will be of a resale at the original purchase price, a loss perhaps of the costs of handling. The anticipation of taxation based upon the profit derived, or of tax deduction based upon the loss sustained, in a resale viewed merely as a contingency—an incident to investment—will never prejudice the municipality.

There is, of course, the possibility that though the investment bidder will not be directly affected by considerations of taxation, he may be indirectly affected by them. Because another class of bidders—those buying for a profitable resale—may be affected by considerations of taxation, the force of competition bearing upon the investment bidder may be relaxed, to some incalculable degree, and thus his bid may be indirectly affected to the prejudice of a State or municipality. We respectively submit that this possibility is so far conjectural, and so difficult to evaluate, that it need not weigh in the constitutional scale; at least not until complaint is made by a State or municipality and supported by some evidence.

What is said above, if it is true, is sufficient for the present case. The respondent says he bought his bonds for

investment, and he does not say enough else about the facts of his transaction to distinguish it from that stated above.

Supererogation.

The conclusion is not different, in any case where the purchaser buys bonds at par. Although the interest rate was fixed by the State or municipality in advance of bidding, presumably it was fixed at a rate identical with the views of the successful bidder; hence his purchase at par.

A different case is presented when bonds bearing 4% are offered to a market which demands 5%. They will be sold at a discount, and the expected appreciation between then and maturity is in the nature of additional interest. It will be a question of fact in each case, whether an excess over purchase price received upon resale is truly profit, or is appreciation in the nature of interest. If the former, *i. e.*, if it is an amount really representing a difference in notions of value at two different points of time *(Ithaca Trust Co. v. United States,* 279 U. S. 151) then the State or municipality was not prejudiced at the former point of time by the possibility of taxation based upon an unpredictable eventuality. If the latter, *i. e.*, if it is an amount partly or entirely in the nature of interest, we are left with a troublesome question of degree to which the State or municipality has been prejudiced, and there are intimations that here also the facts of the particular case control *(Metcalf & Eddy v. Mitchell,* 269 U. S. 514).

It is our understanding that under the federal income tax, as interpreted in the Regulations and Treasury Department decisions, no tax is imposed upon appreciation in the nature of interest, and that possibility may be disre-

garded for present purposes. (Brief of petitioner, upon application for certiorari, page 7.) Another reason why it may be disregarded is because the present record does not show that the "profit" involved is of such nature.

Respectfully submitted,

HAMILTON WARD,
Attorney General of the State of New York.

Brief by:
HENRY S. MANLEY,
Assistant Attorney General.
Albany, January 28, 1930.

CORRECTED COPY

SUPREME COURT OF THE UNITED STATES.

No. 22.—October Term, 1930.

L. M. Willcuts, as Collector of Internal Revenue for the District of Minnesota, Petitioner,
vs.
Charles W. Bunn.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

[January 5, 1931.]

Mr. Chief Justice Hughes delivered the opinion of the Court.

The respondent, Charles W. Bunn, in the years 1919 and 1920 purchased for cash, as investments, bonds issued by various counties and cities in the State of Minnesota. In January, 1924, he sold these bonds, realizing a net profit of $736.26. Upon this net profit, less a net loss of $41.20 suffered by him on similar bonds held less than two years, the Commissioner of Internal Revenue determined an additional income tax in the amount of $85.44. The plaintiff paid this amount to the Collector, under protest, and claimed a refund upon the ground that the tax was illegal because assessed upon income from municipal bonds. The claim was rejected and this suit was brought against the Collector to recover the money paid.

The complaint, alleging these facts, charged that the Revenue Act of 1924, if thus applied, was unconstitutional and void in that the tax was laid upon the instrumentalities of States. Demurrer to the complaint was overruled by the District Court, and, the defendant having declined to plead further, judgment was entered for the plaintiff. The judgment was affirmed by the Circuit Court of Appeals, and this Court granted a writ of certiorari.

The Revenue Act of 1924 (c. 234, sec. 213, 43 Stat. 253, 267, 268, U. S. C. Tit. 26, sec. 954) clearly authorized the tax. The Act included in the term "gross income" the gains and profits derived from "sales, or dealings in property, whether real or per-

sonal." See *Irwin* v. *Gavit*, 268 U. S. 161, 166. The Act gave an express exemption to "interest upon the obligations of a State, Territory or any political subdivision thereof," but this exemption was not extended to profits realized on the sale of such obligations and the statement of the Government is not challenged that it has been the uniform practice of the Treasury Department in administering the federal income tax acts to include in taxable income the gain derived from the sale of state and municipal bonds.

The authority of the Congress to lay a tax on the profit realized by an investor from the sale or conversion of capital assets in general is not open to dispute and is not disputed. That is a matter of governmental policy and not of constitutional power.[1] The question raised here is not because the securities sold were capital assets but because they were governmental in character.

The question is further limited by the fact that it does not appear that the securities were issued at a discount, so that the gain derived could be considered to be in lieu of interest. Whatever questions might arise in cases of that sort are not now before the court.[2] The present case is simply one of profit obtained from purchase and sale, without qualification by any special circumstances.

The well-established principle is invoked that a tax upon the instrumentalities of the States is forbidden by the Federal Constitution, the exemption resting upon necessary implication in order effectively to maintain our dual system of government.[3] The familiar aphorism is "that as the means and instrumentali-

[1]Merchants' Loan and Trust Co. *v.* Smietanka, 255 U. S. 509, 519, 520; Goodrich *v.* Edwards, 255 U. S. 527; Walsh *v.* Brewster, 255 U. S. 536.

[2]It appears that the Treasury Department has ruled that where a municipality originally issues a bond at a discount and redeems it at par, the return represented by the discount is interest in another form and is not taxable. See O. D. 647, Cumulative Bulletin No. 3, July-December, 1920, p. 123; O. D. 737, *id.* p. 49; O. D. 762, Cumulative Bulletin No. 4, January-June, 1921, p. 31.

[3]Collector *v.* Day, 11 Wall. 113, 127; United States *v.* Railroad Company, 17 Wall. 322, 327; Mercantile Bank *v.* New York, 121 U. S. 138, 162; Pollock *v.* Farmers' Loan & Trust Company, 157 U. S. 429, 584-586; *id.*, 158 U. S. 601, 618; Ambrosini *v.* United States, 187 U. S. 1, 17; Metcalf & Eddy *v.* Mitchell, 269 U. S. 514, 523; National Life Insurance Company *v.* United States, 277 U. S. 508, 521.

ties employed by the General Government to carry into operation the powers granted to it are exempt from taxation by the States, so are those of the States exempt from taxation by the General Government." *Ambrosini* v. *United States*, 187 U. S. 1, 7. And a tax upon the obligations of a State or of its political subdivisions falls within the constitutional prohibition as a tax upon the exercise of the borrowing power of the State. *Pollock* v. *Farmers' Loan & Trust Company*, 157 U. S. 429, 584-586; *id.*, 158 U. S. 601, 618; *National Life Insurance Company* v. *United States*, 277 U. S. 508, 521.

The limitation of this principle to its appropriate applications is also important to the successful working of our governmental system. The power to tax is no less essential than the power to borrow money, and, in preserving the latter, it is not necessary to cripple the former by extending the constitutional exemption from taxation to those subjects which fall within the general application of non-discriminatory laws, and where no direct burden is laid upon the governmental instrumentality, and there is only a remote, if any, influence upon the exercise of the functions of government. This distinction has had abundant illustration. Thus, while the salary of an officer of the State cannot be taxed by the Federal Government, the compensation paid by a State or a municipality to a consulting engineer, who is neither an officer nor an employee of government, for work on public projects, may be subjected to a federal income tax. *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514, 524. No constitutional implications prohibit a non-discriminatory tax upon the property of an agent of government merely because it is the property of such an agent and used in the conduct of the agent's operations and necessary for the agency. *M'Culloch* v. *Maryland*, 4 Wheat. 316, 436; *Railroad Company* v. *Peniston*, 18 Wall. 5, 33; *Central Pacific Railroad Company* v. *California*, 162 U. S. 91, 126; *Baltimore Shipbuilding Company* v. *Baltimore*, 195 U. S. 375, 382; *Choctaw, Oklahoma & Gulf Railroad Company* v. *Mackey*, 256 U. S. 531, 537. The Congress may tax state banks upon the average amount of their deposits, although deposits of state funds by state officers are included. *Manhattan Company* v. *Blake*, 148 U. S. 412. Both the Congress and the States have the power to tax transfers or successions in case of death, and this power extends to the taxation by a State of bequests to the United States, and to the

taxation by the Congress of bequests to States or their municipalities. *United States* v. *Perkins*, 163 U. S. 625; *Snyder* v. *Bettman*, 190 U. S. 249, 253, 254.

In the case of the obligations of a State or of its political subdivisions, the subject held to be exempt from federal taxation is the principal and interest of the obligations. *Pollock* v. *Farmers' Loan & Trust Company, supra.* These obligations constitute the contract made by the State, or by its political agency pursuant to its authority, and a tax upon the amounts payable by the terms of the contract has therefore been regarded as bearing directly upon the exercise of the borrowing power of the government. In *Weston* v. *Charleston*, 2 Pet. 449, 468, 469, where the tax, laid under an ordinance of the city council upon United States stock which had been issued for loans made to the United States, was held invalid, the principle was thus stated by Chief Justice Marshall: "The right to tax the contract to any extent, when made, must operate upon the power to borrow before it is exercised, and have a sensible influence on the contract. The extent of this influence depends on the will of a distinct government. To any extent, however inconsiderable, it is a burthen on the operations of government. . . . The tax on government stock is thought by this Court to be a tax on the contract, a tax on the power to borrow money on the credit of the United States, and consequently to be repugnant to the constitution". This language was applied by the Court in *Pollock* v. *Farmers' Loan & Trust Company, supra* (157 U. S. at p. 586) in holding invalid federal taxation "on the interest" from municipal securities.

But it does not follow, because a tax on the interest payable on state and municipal bonds is a tax on the bonds and therefore forbidden, that the Congress cannot impose a non-discriminatory excise tax upon the profits derived from the sale of such bonds. The sale of the bonds by their owners, after they have been issued by the State or municipality, is a transaction distinct from the contracts made by the government in the bonds themselves, and the profits on such sales are in a different category of income from that of the interest payable on the bonds. Because the tax in question is described as an "income tax" and the profits on sales are included in "income", the distinction is not lost between the nature of a tax applied to interest and that of a tax applied to gains

from sales. The federal income tax acts cover taxes of different sorts. *Brushaber* v. *Union Pacific Railroad Company*, 240 U. S. 1, 17; *Stanton* v. *Baltic Mining Company*, 240 U. S. 103, 114. The tax upon interest is levied upon the return which comes to the owner of the security according to the provisions of the obligation and without any further transaction on his part. The tax falls upon the owner by virtue of the mere fact of ownership, regardless of use or disposition of the security. The tax upon profits made upon purchases and sales is an excise upon the result of the combination of several factors, including capital investment and, quite generally, some measure of sagacity; the gain may be regarded as "the creation of capital, industry and skill." *Tax Commissioner* v. *Putnam*, 227 Mass. 522, 531.

The tax not being on the obligations of the State or municipality, or on the investment therein, as such, the question is whether the tax must nevertheless be held to be invalid because sales by investors are to be deemed inseparably connected with the exercise of the borrowing power of the State. When the Constitution prohibits States from laying duties on imports, the prohibition not only extends to a tax upon the act of importing, but also to one upon the occupation of the importer or upon the articles imported. A tax on the sale of an article, imported only for sale, is a tax on the article itself. *Brown* v. *Maryland*, 12 Wheat. 419, 444. Similarly, with respect to federal taxation of articles exported from any State, the constitutional inhibition gives immunity to the process of exportation and to the transactions and documents embraced in that process. *Fairbank* v. *United States*, 181 U. S. 283; *United States* v. *Hvoslef*, 237 U. S. 1; *Thames & Mersey Marine Insurance Company* v. *United States*, 237 U. S. 19. Only on that construction can the constitutional safeguard be maintained. Again, when the United States has assumed duties with respect to Indian lands, a State cannot impose an occupation or privilege tax on operations conducted in or upon such lands by lessees who have been constituted federal instrumentalities for the purpose of discharging the Government's obligation, *Choctaw, Oklahoma & Gulf Railroad Company* v. *Harrison*, 235 U. S. 292, 298, or upon the leases themselves or capital stock representing them, *Indian Territory Illuminating Oil Company* v. *Oklahoma*, 240 U. S. 522, 530, or upon the net income of such a lessee, *Gillespie* v. *Oklahoma*, 257 U. S. 501,

504. See, also, *Jaybird Mining Company* v. *Weir*, 271 U. S. 609, 612[4]. These cases are not analogous to the one under consideration. If the tax now in question is to be condemned, it must be because of practical consequences and not because purchases and sales by private owners of state and municipal bonds are a part of the State's action in borrowing money. It would be far-fetched to say that such purchases and sales are instrumentalities of the State. They are not transactions made directly or indirectly in behalf of the State or in the course of the performance of any duty of the State. Sales are merely methods of transferring title to the obligation, that is, the right to receive performance of the promise of the State or municipality.

That a transfer of government bonds is not inseparably connected with the exercise of the Government's borrowing power so as to make the transfer *per se* immune from taxation is clearly demonstrated by the decisions upholding non-discriminatory taxation laid upon the transmission of such securities upon the death of the owner. This Court has decided that a State may lay a transfer tax upon a legacy although it consists entirely of bonds of the United States, *Plummer* v. *Coler*, 178 U. S. 115, and that the Congress may tax the transfer of the net assets of a decedent's estate although municipal bonds are included in determining the net value, *Greiner* v. *Lewellyn*, 258 U. S. 384. In *Plummer* v. *Coler*, *supra* (p. 125), the tax of the State was sustained, despite the provision of the Act of Congress under which the bonds were issued that they should be exempt "from taxation in any form by or under State, municipal, or local authority". *id.*, pp. 134, 135; Act of July 14, 1870, c. 256, sec. 1, 16 Stat. 272; Rev. Stat. sec. 3701; U. S. C. Tit. 31, sec. 742. See, also *Orr* v. *Gilman*, 183 U. S. 278, 289; *Blodgett* v. *Silberman*, 277 U. S. 1, 12, 13. And in *Greiner* v. *Lewellyn*, *supra* (p. 387), the Court said that "the estate tax . . . like the earlier legacy or succession tax, is a duty or excise, and not a direct tax like that on income from municipal bonds. *Pollock* v. *Farmers' Loan & Trust Company*, *supra*. . . . Municipal bonds of a State stand in this respect in no different position from money payable to it. The transfer upon death is taxable, what-

[4]Compare McCurdy v. United States, 246 U. S. 263; Shaw v. Gibson-Zahniser Oil Corporation, 276 U. S. 574, 578, 579.

soever the character of the property transferred and to whomsoever the transfer is made. It follows that in determining the amount of decedent's net estate municipal bonds were properly included." On similar grounds, as the Federal Government has power to tax transfers of property by gift *inter vivos*, *Bromley* v. *McCaughn*, 280 U. S. 124, there would seem to be no question of its constitutional authority to include in such taxation gifts of state or municipal securities.

It is urged however, that a federal tax on the profits of sales of such securities should be deemed, as a practical matter, to lay such a burden on the exercise of the State's borrowing power as to make it necessary to deny to the Federal Government the constitutional authority to impose the tax. No facts as to actual consequences are brought to our attention, either by the record or by argument, showing that the inclusion in the federal tax of profits on sales of state and municipal bonds casts any appreciable burden on the States' borrowing power. We are left to the inadequate guidance of judicial notice. It may be considered to be a matter of common knowledge that the bonds of States and their municipalities are for the most part purchased for investment. But while, in the language of the tax act regarding deductions for losses, the purchase of municipal bonds for investment, as in the case of other investments, may be regarded as "entered into for profit" as distinguished from mere personal use, it may be doubted whether the prospect on the part of the ordinary investor of obtaining profit on the resale of such obligations is so important an element in inducing their acquisition that a federal tax laid on such profits, in common with profits derived from the sales of other property, constitutes any substantial interference with the functions of state governments. While the tax is laid on gains, there is also a deduction for losses on sales, and whether investors in such securities would consider it an advantage if both provisions were eliminated is a matter of mere speculation. It must be remembered that we are dealing, not with any express constitutional restriction, but only with an asserted implication. The constitutional provisions authorizing the Congress to lay taxes (Article I, Section 8; Sixteenth Amendment) are certainly broad enough to cover the tax in question, and before we can restrict their application upon the ground of a burden cast upon the State's borrowing